Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	
	)	

COMMENTS OF SBC COMMUNICATIONS INC.

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SBC Communications Inc. respectfully submits these comments in response to the Commission's Further Notice of Proposed Rulemaking.

INTRODUCTION AND SUMMARY

In a rare display of industry unity, the Intercarrier Compensation Forum—a diverse coalition that includes SBC, rural carriers, a major wireless company, and several competitive providers of local, long-distance, and Internet backbone services—has proposed a comprehensive plan for cutting the Gordian knot of interrelated universal service and intercarrier compensation issues. SBC supports the ICF plan because competition and IP-based convergence have irreversibly derailed the existing regime, with grave consequences for carriers and consumers alike; because no other plan could avert the coming train wreck; and because the ICF plan represents the Commission's best chance for restoring order to the growing regulatory chaos and promoting the long-run interests of consumers.[1]

Any workable proposal for reforming intercarrier compensation rules must promote three core objectives: uniformity in the treatment of similarly situated providers; a stable deregulatory

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[1] These comments offer SBC's perspective on the ICF plan and are designed to supplement the more comprehensive policy and legal justification set forth in the ICF's own comments.

environment that allows the free market to determine winners and losers; and revenue opportunities that allow carriers to meet their universal service obligations despite the elimination of implicit cross-subsidies. The ICF plan is the only proposal that genuinely meets, or even tries to meet, all three of these objectives. First, unlike any other proposal, the ICF plan offers a clear set of rules for direct and indirect network interconnection, thereby resolving the long-boiling interconnection disputes that have preoccupied state commissions since 1996.

Second, the ICF plan alone would create a stable deregulatory environment in which market forces, rather than regulatory decisions, govern the industry's evolution. The traditional system—like most of the other "reform" plans proposed in this proceeding—makes the calling party's carrier (its LEC or interexchange carrier) responsible for covering all network costs involved in the completion of a call. The problem is that the *called* party's carrier has both the incentive and the ability to charge the *calling* party's carrier above-cost rates for terminating these calls. This "terminating monopoly" problem requires regulators to intervene constantly to cap those rates. The result is unending litigation about whether access charges and reciprocal compensation levels accurately represent network costs and the way in which they are incurred.

The ICF plan solves the terminating monopoly problem in a far more market-oriented way by requiring each carrier to recover its termination costs from its own subscribers (sometimes supplemented by USF mechanisms), rather than from other carriers—and indirectly from *their* subscribers. In the process, the ICF plan should *not* increase overall consumer prices, as some suggest; indeed, it should lower them by ensuring that consumers pay directly and efficiently the termination costs they already pay indirectly and inefficiently in the form of passed-through intercarrier compensation. Moreover, by shifting cost-recovery mechanisms in this manner, the plan will subject the recovery of all such costs to the discipline of market forces whenever consumers have a choice among retail providers. The plan will thus give all carriers strong incentives to enhance the efficiency of their networks in order to reduce the rates they can profitably charge end users. Over the long term, as competition eliminates the need for retail rate caps, the ICF plan will permit nearly complete long-term deregulation of the telecommunications industry.

Third, unlike several alternatives, the ICF plan makes an uncompromising commitment to universal service. For example, it will replace the large implicit cross-subsidies embedded in access charges with new opportunities for carriers to recover their network costs, either directly from end users in the form of relaxed SLC caps or from competitively neutral funding mechanisms. Some alternative plans would deny these new revenue opportunities while slashing current revenues. But that course would not only violate the Commission's legal obligations to ensure carriers an opportunity to recover their costs, but threaten the long run integrity of the universal service system. Significantly, moreover, the ICF plan does not *guarantee* "revenue neutrality" for any carrier; it simply removes regulatory impediments to a carrier's *opportunity* to recover its network costs. For example, competition might well preclude such carriers from raising the SLC to the levels permitted under the plan.

Finally, the ICF plan achieves these three objectives—uniformity, market-oriented outcomes, and universal service—through a fine balance of puts and takes. In developing the ICF Plan, each participant made compromises to achieve a global solution that would work for consumers and the industry as a whole, not just themselves or one narrow industry segment. The Commission cannot now pick and choose among the plan's constituent parts and assume that such piecemeal action would be lawful, sensible, or supported by the plan's current sponsors. For example, the Commission cannot reform intercarrier compensation by eliminating all access charges without providing some opportunity for carriers to recover their lost cross-subsidies through relaxation of SLC caps and, where necessary, the provision of additional explicit universal service support. Similarly, while SBC fully supports the transit obligations incorporated as a component of the integrated ICF plan, these obligations apply only to carriers that already provide transit voluntarily, and are designed to work in tandem with the plan's other components. SBC's commitment to the plan's transit provisions does not signal support for broader Commission (or state commission) oversight of transit, particularly at TELRIC-based rates.[2]

DISCUSSION

I. The ICF Plan Alone Promotes All of the Basic Objectives of Intercarrier Compensation Reform

The ICF proposal is the only plan before the Commission that promises to meet all of the basic objectives that any reform plan *must* meet if it is to resolve, rather than worsen, the inextricably interrelated disputes and arbitrage opportunities that are now destabilizing the industry. These objectives can be grouped into three basic categories.

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[2] Transit is not a function of a carrier's obligations under section 251(c) of the Act, as the Wireline Competition Bureau indicated in the *Virginia Arbitration*. As the Wireline Competition Bureau noted there, "the Commission has not had occasion to determine whether incumbent LECs have a duty to provide transit service under [47 U.S.C. § 251(c)(2)]." Memorandum Opinion and Order, *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, 17 FCC Rcd 27039, 27101 ¶ 117 (2002) ("*Virginia Arbitration*"); *see also id.* (noting the absence of "clear Commission precedent or rules declaring such a duty"). Moreover, while the ICF's legal analysis argues that section 251(a) can be construed to require an ILEC to *continue* providing transit once it already has assumed that obligation (if for no other reason than to avoid unnecessary network disruptions), it is a separate question whether section 251(a) could be read to require a carrier to act as an intermediary and provide transit in the first instance (and the ICF brief does not address that issue). The Commission does, however, have limited jurisdiction under section 201 of the Act to prevent carriers from *disrupting* indirect interconnection once carriers are relying on it.

- First, any constructive intercarrier compensation plan must propose *uniform* rules for network interconnection and recovery of the costs of transport and termination. Artificial regulatory distinctions, detached from any underlying economic or technological foundation, inflict enormous costs on the industry and the public by focusing carriers' energy on arbitrage opportunities, or litigation-intensive countermeasures, rather than on competition to enhance value and efficiency for consumers.

- Second, any intercarrier compensation plan should create a stable regulatory environment conducive to *market-oriented outcomes*, in which carriers succeed or fail on the basis of the economic value they create for consumers, not on the basis of their regulatory acumen.

- And last but not least, the new plan must reconcile the reform of intercarrier compensation rules with the closely related challenge of continuing to meet *universal service needs*. This means that the plan must afford carriers-of-last-resort—rural and non-rural alike—at least the *opportunity* to recover, through end user fees and USF disbursements, whatever implicit subsidies they lose through reductions in intercarrier compensation payments.

Together and individually, these three goals should be uncontroversial. But the ICF plan is the only comprehensive plan that seriously proposes to achieve, and actually is capable of achieving, them all.

A. The ICF Plan Best Promotes Regulatory Uniformity

Unlike the other proposals discussed in the FNPRM, the ICF plan would bring regulatory uniformity to an industry that badly needs it. *First*, the plan provides default rules to govern the *interconnection* of networks. Interconnection issues have been a source of prolonged and wasteful litigation at least since 1996.[3] Many regulatory battles have raged, for example, over the number and location of points of interconnection between carrier networks.[4] The ICF plan

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[3] Indeed, such disputes—for example, between cellular and wireline carriers—even preceded the 1996 Act. *See, e.g.*, Report and Order, *Cellular Communications System*, 86 F.C.C.2d 469, 495-96 ¶¶ 53-57 (1981) (discussing the terms for interconnection of cellular systems with the public switched telephone network).

[4] *See, e.g., Virginia Arbitration* at 27057-77 ¶¶ 36-71.

eliminates the need for such fights. Although it leaves carriers free to agree to any contrary arrangement, the plan specifies default points of interconnection (Network Edges) for all networks, whether hierarchical, non-hierarchical, or rural.[5]

The certainty created by these new rules will put an end to many years of inconclusive litigation about these interconnection issues before the FCC and dozens of state commissions. No other plan proposes, in any meaningful detail, an alternative solution to these network interconnection disputes.[6] To the contrary, the other plans would defer any resolution of this entire critical set of issues, thereby indefinitely encouraging the types of regulatory gamesmanship that will undermine the very stability that intercarrier compensation reform is supposed to achieve.

Second, the ICF plan is the only proposal that establishes uniform rules to govern carriers' financial responsibility for traffic. At the designated Network Edges, carriers transfer *financial* responsibility for traffic, although they retain the right to request *physical* interconnection "at any technically feasible point."[7] And the plan specifies not just the terms of

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[5] Ex Parte Brief of the Intercarrier Compensation Forum in Support of the Intercarrier Compensation and Universal Service Reform Plan, filed in CC Docket No. 01-92 (Oct. 5, 2004), App. A at 4-31 ("*ICF Plan*").

[6] NASUCA, for example, affirmatively argues that no changes need to be made to the rules governing interconnection. NASUCA Principles, filed in CC Docket No. 01-92 (Dec. 17, 2004) at 1 ("The NASUCA proposal does not require any change in the current definition of network 'edges' or wholesale and retail relationships."). Similarly, the CBICC and ARIC plans advocate maintenance of existing disparities in network interconnection rules. CBICC Plan, filed in CC Docket No. 01-92 (Sept. 2, 2004) at 3 (providing that "[t]he current interconnection rules remain in place"); ARIC Plan, filed in CC Docket No. 01-92 (Oct. 25, 2004) at 2, 114 (supporting retention of most of the existing network interconnection rules). And plans that do acknowledge the need for reform of the interconnection rules either do not provide uniform rules, *see* Home/PBT Plan, filed in CC Docket No. 01-92 (Nov. 2, 2004) at 13-14, or offer inadequate descriptions of what that reform would look like, Western Wireless Plan, filed in CC Docket No. 01-92 (Dec. 1, 2004) at 12; EPG Plan, filed in CC Docket No. 01-92 (Nov. 2, 2004) at 30-31.

[7] 47 U.S.C. § 251(c)(2).

direct interconnection between calling and called parties' networks, but also, where applicable, the rates and terms of *indirect* interconnection for transiting arrangements. Through these mechanisms, the ICF plan will ensure much-needed uniformity in the *rate structure and rate levels* for intercarrier compensation payments.

It should be common ground that competition and technological change are irreversibly undermining the traditionally bifurcated regime of reciprocal compensation for "local" calls and access charges for "long distance" calls. Such arbitrary regulatory distinctions inflict enormous costs on the industry and the public by focusing carriers' energy on arbitrage opportunities, or litigation-intensive countermeasures, rather than on competition to enhance value and efficiency for consumers. The ICF plan will conclusively resolve these concerns. First, over the course of three years, the plan will unify, into a single coherent compensation regime, the disparate schemes that now govern switched access, reciprocal compensation, ISP-bound traffic, inter- and intra-MTA CMRS traffic, and traffic either originating or terminating on IP networks. After a transitional period, the plan will then prescribe, on a national basis, a termination rate of zero for *all* traffic—local and access—when dropped off at the applicable Network Edge and a terminating transport rate of zero for all except qualifying rural carriers. The ICF plan thus will harmonize the different compensation schemes for different services and carriers. In short, the ICF Plan will focus carriers' attention on efficiently serving their subscribers rather than exploiting regulatory arbitrage opportunities with other carriers.

By contrast, most of the other reform proposals would perpetuate entirely arbitrary distinctions between services for purposes of determining compensation. For example, by requiring long distance carriers (as "retail" providers) to pay originating access charges to the calling party's LEC, the ARIC and CBICC proposals would have the effect of attaching long-term significance to the distinction between retail local and long distance traffic.[8] ARIC also would permit a rural carrier to pay less to terminate calls on other local networks than it would charge for termination on its own network, explaining that "while rates will be unified for all carriers using a particular LEC's network, cost differences between LECs necessitate different LEC rate levels."[9] In fact, most of the plans that claim to bring uniformity to the intercarrier compensation rules fall seriously short on that promise. The EPG proposal, for example, would likewise entitle different carriers to quite different intercarrier compensation levels[10] and would replace the existing regime with one that would introduce a number of *new*—and different—types of intercarrier charges.[11] Finally, most of these other plans would contain a fatal jurisdictional flaw in that they would have the Commission prescribe specific *and positive* intercarrier charges for all traffic, including jurisdictionally intrastate traffic, even though section 252 contemplates a state role in "establishing rates" that implement the FCC's more general choice of "pricing methodology."[12]

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[8] *See, e.g.,* ARIC Plan at 34. This feature would perpetuate the current, unstable scheme of implicit cross-subsidies, since those originating access charges would be subject to the toll rate averaging requirement of section 254(g). As discussed below, the ICF plan avoids this problem by eliminating access charges altogether.

[9] *See* ARIC Plan at 37 (under ARIC approach); *see also id.* at 39-41 (discussing proposed termination rates for rate-of-return LECs); *id.* at 42-43 (discussing different proposed termination rates for price-cap LECs).

[10] *See* EPG Plan at 6 & n.4.

[11] *See id.* at 7-8, 20, 22, 29-30. The new charges would include the "ARC" ("access restructure charge") and specialized "port" and "link" charges, as supplemented by the "OVFS" ("optional variable federal SLC"). ARIC and EPG claim that they will be uniting their public advocacy on intercarrier compensation issues, and may be abandoning both existing plans, but they have yet to do so. We have therefore addressed the existing proposals of the two groups.

[12] *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 384 (1999); *see* 47 U.S.C. § 252(c)(2). While some have charged that the ICF plan suffers from this same flaw, they ignore that the statute contains an important exception to this state role where (as under components of the ICF plan) the FCC adopts bill-and-keep as its pricing methodology. *See* 47 U.S.C. § 252(d)(2)(B)(i); *see also WorldCom, Inc. v. FCC*,

Just as problematic are the proposals in the ARIC and the CBICC plans to place the burden on an end user's "retail" provider to pay all carriers whose networks are involved in the placement of a call.[13] That approach would raise deeply indeterminate questions about who counts as a "retail" provider for these purposes. For example, when a broadband customer signs up for service with an independent VoIP provider (or ISP, or on-line music service, etc.), does that provider count as the retail provider, thereby incurring an obligation to pay, for the first time, compensation to the customer's broadband provider for use of its platform? If not, why not? Such questions underscore the radical uncertainties that either of these plans would inject into intercarrier compensation policy—as well as the regulatory morass they would introduce into the Internet sphere, which to date has been free of such disputes. Of the competing plans in this proceeding, only the ICF plan is robust enough to prescribe determinate rules that will still make sense, and can be easily and consistently applied, as increasing amounts of traffic move onto the Internet.

B. The ICF Plan Best Promotes Market-Oriented Outcomes

The ICF plan likewise stands head and shoulders above the other plans in devising a transition toward a stable deregulatory environment in which consumer preferences, rather than regulatory decisions, shape the future of the marketplace.

This proceeding addresses one of the most vexing questions in telecommunications policy: compensation for the costs of terminating calls that pass through more than one network.

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288 F.3d 429, 434 (D.C. Cir. 2002) (finding that "there is plainly a non-trivial likelihood that the Commission has authority to elect" a bill-and-keep system for ISP-bound traffic under section 252(d)(2)(B)(i), thereby eliminating the power of states to set a positive rate for such traffic even if it falls within the scope of section 251(b)(5)).

[13] ARIC Plan at 33-36; CBICC Plan at 2.

Under any regulatory approach, consumers end up paying those costs one way or another; the question is whether they will pay them directly or indirectly. The traditional "calling party's network pays" (CPNP) solution—which encompasses both the reciprocal compensation and the access charge regimes—takes the indirect approach. The premise of CPNP is that a calling party "causes" the costs of any call[14] and that the calling party's carrier should therefore cover those costs by compensating the called party's carrier for its costs in terminating the call.[15] Under any CPNP system, therefore, each carrier recovers a portion of its network costs (those associated with call termination) from other carriers—and, ultimately, from those other carriers' subscribers. With the exception of the Western Wireless and CTIA submissions, all the other proposals in this proceeding are variations on the CPNP approach, for all would require the calling party's carrier to compensate the other carriers involved in the completion of a call.

The basic problem with the CPNP approach is that any carrier, no matter how competitive the retail market may become, retains a "terminating access monopoly" for incoming calls to a particular telephone number. That is, once selected by a particular subscriber, a carrier will typically control the only line available for terminating a given

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[14] In fact, as the Commission's own staff study makes clear, even this abstract economic rationale for the CPNP regime is flawed: *both* parties to a given call benefit from it and can be characterized as cost-causers. *See* Further Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, FCC 05-33, App. C at 98-103 (rel. Mar. 3, 2005) ("*FNPRM*").

[15] Traditional three-carrier long-distance calls are subject to a variation on CPNP: the calling party's carrier for purposes of such calls is the IXC in the middle, and it must cover all costs of the call, both on the originating end and on the terminating end. In unregulated competitive markets, there is no "originating access monopoly," because an IXC could pass any supracompetitive origination access charges back to the *specific* end users who make the calls that trigger those charges, and those end users would hold responsible the LECs that impose them. Because the rate averaging requirement of section 254(g) frustrates that market dynamic, however, regulation would remain necessary in perpetuity to cap originating access charges. This factor, too, is a reason to support any plan that, like the ICF proposal, eliminates access charges altogether.

telephone call to that subscriber, and it thus will have both the incentive and the ability to impose above-cost charges on the other carriers whose calls it terminates.[16] This problem, in a nutshell, explains why for decades policymakers have found it necessary to conduct drawn-out regulatory proceedings for the purpose of capping termination rates for calls (whether local or long distance) crossing more than one network.[17]

The ICF plan offers a completely different solution to the terminating access monopoly. Under the plan, each provider will recover all of its network costs, including those associated with call termination, directly from *its own* subscribers (except to the extent it may be entitled to supplemental funding from competitively neutral USF mechanisms). As a result, the ICF plan, unlike any CPNP approach, will subject the recovery of all such costs to the discipline of market forces whenever consumers have a choice among retail providers. If a given provider is less efficient than others, or if it seeks to recover rates above economic costs, its retail rates will likely exceed those of other providers, and subscribers can vote with their feet. With the inexorable growth of retail competition, the threat of such defection will keep each provider's rates at efficient, cost-based levels. Market forces will likewise reward carriers that keep

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[16] *See FNPRM* ¶ 24 ("Even when an end user takes service from two providers, *e.g.*, wireless and wireline, the originating carrier must deliver the call to the terminating carrier with the telephone number dialed by the calling party. Other carriers seeking to deliver calls to that end user have no choice but to purchase terminating access from the called party's LEC. Originating carriers generally have little practical means of affecting the called party's choice of access provider, and the called party's LEC may take advantage of the situation by charging excessive terminating rates to a competing LEC.").

[17] *See, e.g.*, Seventh Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*, 16 FCC Rcd 9923, 9924-25, 9926-27 ¶¶ 2-3, 10-11 (2001) (regulating the considerably above-cost interstate access charges imposed by CLECs); Order on Remand and Report and Order, *Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151, 9154 ¶ 4 (2001), *remanded on other grounds*, *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002) ("*ISP Remand Order*") (regulating intercarrier payments for ISP-bound traffic and noting that, in the absence of a bill-and-keep regime, "carriers have every incentive to compete, not on basis of quality and efficiency, but on the basis of their ability to shift costs to other carriers").

increasing the efficiency of their networks by reducing unnecessary costs, and will punish those that do not.

Significantly, although it will shift *direct* recovery of costs from carriers to end users, the ICF plan should *not* increase rates for end users overall. To the contrary, it will simply ensure that consumers pay directly and efficiently the termination costs they now already pay indirectly and inefficiently (in the form of passed-through intercarrier compensation). Indeed, the ICF plan should lead to *lower* charges for end users in the aggregate because of the greater efficiencies it will unleash by exposing, for the first time, the recovery of all network costs to market forces. And by making each carrier substantially more accountable to its customers for the recovery of its own costs, the ICF plan will maximize direct consumer control over the market's evolution.

Closely related to such consumer empowerment is another of the plan's key benefits: deregulation. Over the long term, as competition grows and obviates the need for retail rate caps, the ICF plan steers a course toward nearly complete long-term deregulation of the telecommunications industry. Over the shorter term as well, the ICF plan prescribes a highly predictable ramp-down to an industry-wide regime that, once implemented, can run essentially on autopilot.

Both of these features—consumer empowerment and deregulation—set the ICF plan apart from the CPNP-based alternatives. Under those alternatives, each carrier would continue recovering its call termination costs from other carriers (and ultimately their customers), subject to little market discipline and only to whatever rate caps regulators have imposed. And regulators following a CPNP approach would need to continue regulating termination rates in perpetuity to keep them roughly similar, as technology evolves, to the underlying costs of the many different types of networks that perform termination functions. The terminating access monopoly would continue confronting regulators with that need *even after* competition otherwise frees the market from any need for retail rate regulation. By requiring permanent regulatory involvement, these other plans would thus indefinitely preserve the potential for regulatory mechanisms to create, or destroy, entire industries through miscalculation (and subsequent correction) of termination costs and rates, as happened most recently in the case of ISP-bound traffic.[18]

In all of these respects, any CPNP plan—and thus virtually any proposal besides the ICF plan—would preserve regulation as a source of constant litigation at best and profound market distortion at worst. Indeed, a number of competing plans, such as those offered by rural carriers, could radically *increase* the degree of overall regulatory intervention by imposing Title II regulation on peering and transit arrangements on the now-unregulated Internet backbone.[19] This feature is an immense shortcoming. History reveals the near-impossibility of setting usage-

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[18] *See ISP Remand Order, supra*. A related shortcoming of any CPNP plan is the burden it places on regulators, rather than market forces, to address disparities in the cost structure of different types of networks. Under any CPNP plan—including today's reciprocal compensation regime—each provider has constant incentives to seek an edge over its competitors by persuading regulators to raise *its* termination rates (on the basis of its particular network cost characteristics) while lowering its *competitors'* termination rates (on the basis of their different network cost characteristics). Today, for example, wireless and wireline providers argue about their respective termination costs, as do ILECs (with their hierarchical networks) and CLECs (with their longer loops, fewer switches, and sometimes simpler termination functions). *See, e.g.,* Order, *Cost-Based Terminating Compensation for CMRS Providers*, 18 FCC Rcd 18441, 18442, 18444-45 ¶¶ 3, 8 (2003) (concluding that CMRS carriers are entitled to "asymmetric reciprocal compensation" if they can prove that their transport and termination costs exceed those of ILECs); Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 16 FCC Rcd 9610, 9647 ¶ 103 (2001). Carriers often try to exploit the regulatory process governing such issues to gain a net advantage in the intercarrier compensation sweepstakes. There is no straightforward, competitively neutral way for regulators to adjudicate such disputes about relative network costs. But such disputes will arise as long as the rules allow carriers to prosper by persuading regulators, rather than the market, to allow favorable compensation levels for particular network characteristics.

[19] *See, e.g.,* ARIC Plan at 102-107.

sensitive rates at the "right" levels and structures.[20] Competition is far more effective than regulation in matching rates to underlying costs—and, more generally, in promoting economic efficiency and consumer welfare.[21] The ICF plan maximizes the role of competition and consumer choice in the process of network cost-recovery; the CPNP approach does not.

Finally, even if a CPNP approach remains in place, it would be particularly unreasonable to choose TELRIC as the primary cost methodology, as CBICC proposes. First, as the Commission itself has all but acknowledged,[22] and as SBC has explained in detail in separate comments devoted to this issue,[23] the current version of TELRIC is methodologically flawed because of a core internal inconsistency: it posits a fully competitive market for some inputs (such as the extent to which technological or demographic change instantaneously adjusts asset values) and a market dominated by a single ubiquitous provider for other inputs (such as scale economies, capital costs, and depreciation). By mixing and matching these contradictory assumptions, and by choosing for each cost model input and variable whichever assumption

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[20] *See, e.g.*, *United States Tel. Ass'n v. FCC*, 188 F.3d 521, 531 (D.C. Cir. 1999) (remanding the Commission's decision to increase the "X-factor"); *ISP Remand Order* at 9185-86 ¶ 76 "it is entirely impracticable, if not impossible, for regulators to set different intercarrier compensation rates for each individual carrier, and those rates still might fail to reflect a carrier's costs as, for example, the nature of its customer base evolves").

[21] *See FNPRM* App. C at 107-08 ("regulators rarely have sufficient information or sufficient resources to establish rates that accurately reflect the cost of providing service" and that "the marketplace, rather than regulatory intervention, is the best mechanism for constraining end-user rates").

[22] Notice of Proposed Rulemaking, *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, 18 FCC Rcd 18945, 18964-65 ¶¶ 49-51 (2003) ("*TELRIC NPRM*").

[23] Comments of SBC Communications Inc., *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, filed in WC Docket No. 03-173, Dec. 16, 2003, at 13-20; Reply Comments of SBC Communications Inc., *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, filed in WC Docket No. 03-173, Jan. 30, 2004, at 8-12.

tends to lower estimated network costs, the current formulation arbitrarily drives down wholesale rates below any coherent understanding of cost and thereby distorts the entry and investment decisions of all carriers. Second, the typical TELRIC proceeding is (in the Commission's words) a complete "black box,"[24] producing rates that vary wildly from state to state and from year to year, based on the disparate methodological choices of regulators rather than on any differences in underlying costs. In fact, the industry's (and regulators') experience with TELRIC exemplifies why *any* CPNP-oriented plan—which requires permanent rate regulation for the recovery of wholesale costs—is a recipe for permanent and severe regulatory uncertainty.

C. Only the ICF Plan Prescribes a Comprehensive Solution to the Problem of Universal Service in a Competitive Age

Reforming today's intercarrier compensation rules presents the need for an equally ambitious reform of universal service funding to maintain affordable service despite the loss of implicit cross-subsidies contained in today's intercarrier compensation payments—access charges in particular. As discussed in section III(C) below, the Commission should promptly replace today's unsustainable and competitively biased *USF contribution methodology* with the ICF's neutral approach based on telephone numbers and connections to a public network—and it should do so promptly whether or not it simultaneously reforms intercarrier compensation. In this section, we address the separate but equally important need to provide carriers the opportunity to recover their costs if implicit cross-subsidies are eliminated from intercarrier compensation, as proposed in the ICF plan.

Although the ICF plan eliminates most intercarrier charges, including some that are heavily subsidy-laden, it replaces those charges with new opportunities for efficient recovery of

[24] *TELRIC NPRM* at 18949 ¶ 7.

the same network costs, either directly from end users in the form of higher caps on the subscriber line charge ("SLC") or from competitively neutral funding mechanisms. Notably, the ICF plan does not *guarantee* the recovery of these network costs; it simply removes regulatory impediments (in the form of SLC caps) to a carrier's *opportunity* to recover such costs. Competition from VoIP, wireless, and other providers might well preclude ILECs from raising the SLC to the levels formally permitted under the plan, even though keeping the SLC at lower levels (to meet such competition) would make ILECs financially worse off than they are today. Ultimately, in fact, competition may keep ILECs from including any "subscriber line charge" as a separate line-item on monthly bills.

The thrust of several other proposals, such as CBICC's, is that carriers should face dramatic reductions in their intercarrier compensation revenues, including those that indisputably embody substantial implicit subsidies, with no adequate opportunity to make up for all the lost compensation from other sources.[25] If implemented, such a proposal would be unlawful—and not just for rural carriers. As the FCC has repeatedly recognized, current access charges are designed to cover an ILEC's real *costs*—specifically, (i) the costs of the call origination and termination functions themselves and (ii) sometimes, particularly at the state level, the costs of serving high-cost customers at below-cost rates.[26] Cuts to one source of revenues must be matched by substantially equivalent new revenue opportunities, whether through adjustments to end user charges or through new universal service funding mechanisms.

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[25] *See* CBICC Plan at 2 (anticipating that "only rural carriers will possibly need USF funding"); *see also* Western Wireless Plan at 2-3, 7, 15-16, 18; NASUCA Principles at 1-2.

[26] *See, e.g., FNPRM* ¶¶ 8-11 (discussing the Commission's efforts to align access charges more closely with costs); *id.* ¶ 8 n.20 (noting that "rates for local telephone service in rural and high cost areas had been implicitly subsidized by charging high-volume long-distance callers and urban residents artificially higher rates").

In the absence of such opportunities, carriers saddled with high, unrecovered costs would have one of two options: either withdraw service from higher cost areas or, where carrier-of-last-resort obligations preclude that option, raise rates in those areas to the extent permitted by state PUCs—recognizing that those rate increases may not be high enough and service may suffer as costs are cut. Either result would disserve consumers in high cost and rural areas and violate section 254 of the Act, which requires the Commission to ensure that consumers in those areas have "reasonably comparable" services and that the rates they pay are "just, reasonable, and affordable" and "reasonably comparable to rates charged . . . in urban areas."[27] Moreover, under the Takings Clause, the Commission cannot lawfully eliminate rates that currently cover carriers' costs without giving those carriers an adequate opportunity to cover those costs in some other way.[28] In reforming intercarrier compensation, the Commission can meet that constitutional obligation by relaxing SLC caps or augmenting explicit support mechanisms or both. What it may not do is eliminate cost recovery mechanisms without replacing them. The ICF Plan makes clear provision for the adequate replacement of implicit support through such mechanisms; the CBICC and Western Wireless proposals do not.

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[27] 47 U.S.C. § 254(b)(1), (3).

[28] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307-10 (1989); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944) (government must permit utilities "to operate successfully, to maintain . . . financial integrity, to attract capital, and to compensate . . . investors for the risk assumed"); *see also Brooks-Scanlon Co. v. Railroad Comm'n*, 251 U.S. 396, 399 (1920) ("[a] carrier cannot be compelled to carry on even a branch of business at a loss"). Similarly, the D.C. Circuit has recognized that "[i]t is well settled that utility investors are entitled to recoup from consumers the full amount of their investment in depreciable assets devoted to public service." *Democratic Cent. Comm. v. Washington Metro. Area Transit Comm'n*, 485 F.2d 786, 808 (D.C. Cir. 1973).

II. To the Extent the Commission Addresses Some Intercarrier Compensation Issues Before Others, It Should Resolve Them In a Manner Consistent With Comprehensive Long-Term Reform

SBC urges the Commission to adopt the ICF plan promptly and thereby comprehensively resolve today's seamless web of intercarrier compensation problems. The Commission may nonetheless be urged, in this proceeding or others, to address particular issues in isolation before tackling intercarrier compensation reform as a whole. This section addresses several such issues and how the Commission may harmonize its resolution of them with its longer-term reform goals.

A. Access Charges for VoIP-PSTN Traffic

1. One of the most destabilizing trends in the modern communications industry is escalating uncertainty about the intercarrier compensation rules that apply at the intersection of the Internet and the PSTN: when VoIP providers (and their CLEC partners) make use of the PSTN not to reach their own subscribers, but to reach third parties that are not their customers and with whom they have no contractual relationship, such as PSTN-end users at the terminating end of a call placed by a VoIP subscriber. VoIP providers have invoked the "ESP exemption," discussed below, to claim immunity from any obligation to pay access charges for traffic they hand off to the PSTN, even though the PSTN subscriber receiving a call placed by a VoIP subscriber is *not receiving an information service*, but simply a basic telephone call over the PSTN. These providers argue that they should be assessed, instead of access charges, only the lower reciprocal compensation rate for the termination of these calls, even though conventional long distance carriers would continue paying access charges—and would, to that extent, be artificially disadvantaged when competing against these VoIP providers for customers.

The best way for the Commission to resolve this controversy is to adopt the ICF plan, which moots the issue altogether by first unifying "access charges" and "reciprocal compensation" into a unified set of intercarrier payments and then eliminating such payments completely in all but a limited set of circumstances (involving customers served by rural carriers). Indeed, this is the only viable long-term solution. In the interim, however, the Commission should reject proposals to create *new* regulatory disparities that would distort competition still further. Instead, it should reaffirm that carriers delivering VoIP traffic to the PSTN owe access charges for that traffic on the PSTN end of calls, regardless of whether the service provided to VoIP customers is classified as an information service.

SBC has discussed this issue in several prior submissions, and offers just a summary here.[29] In brief, expanding the ESP exemption to cover VoIP providers and their CLEC partners in isolation from broader reform would jeopardize the stability of the PSTN by abruptly eliminating access charges for IP-PSTN traffic without accounting for the implicit universal service support those charges contain.[30] The Commission cannot rationally grant such piecemeal relief to VoIP providers and their CLEC partners without simultaneously creating a new mechanism to replace this lost support. By applying its access charge rules in a uniform and competitively neutral manner to all users of local switching facilities until wholesale intercarrier

[29] *See* Opposition of SBC Communications Inc., *Level 3 Communications LLC Petition for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of 47 U.S.C. § 251(g), Rule 51.701(b)(1), and Rule 69.5(b)*, WC Docket No. 03-266, at 9-18 (filed Mar. 1, 2004) ("SBC Opposition to Level 3 Forbearance Petition"); Letter from James C. Smith to Michael K. Powell, WC Docket No. 03-266 (Feb. 3, 2005). SBC incorporates those arguments by reference, and restates them here for purposes of ensuring a complete record in this proceeding.

[30] Order on Remand, *Access Charge Reform; Price Cap Performance Review for LECs*, 18 FCC Rcd 14976, 14979 ¶ 5 (2003) (noting that "implicit support flows . . . enable carriers to serve high-cost areas at below-cost rates"); *FNPRM* ¶ 98 (noting that "access charges continue to represent a significant revenue source" for ILECs).

compensation reform is achieved, the Commission will achieve its stated goal of ensuring that the costs of the PSTN are paid for by all that use it,[31] while eliminating opportunities for regulatory arbitrage and preserving a critical component of ILECs' ability to provide communications services at affordable rates. In addition, as SBC has explained elsewhere, expanding the ESP exemption to cover VoIP providers and their CLEC partners, but maintaining the access charge regime for other carriers, would give rise to enormous implementation problems and opportunities for fraud.

In short, until it is prepared to undertake comprehensive reform as proposed in the ICF plan, the Commission should apply its existing access charge rules in a uniform and competitively neutral manner to *all* users of local switching facilities. As such, under *existing* rules, "jurisdictionalized" compensation (interstate or intrastate access charges) applies to IP-PSTN traffic, until the Commission determines otherwise. However, the Commission should declare, on a going forward basis, that the applicable charges for all VoIP-PSTN calls are *interstate* access rates.[32] When an ILEC's local exchange switching facilities are used for the provision of jurisdictionally interstate services, as the Commission has properly characterized IP-

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[31] *See* Notice of Proposed Rulemaking, *IP-Enabled Services*, 19 FCC Rcd 4863, 4885 ¶ 33 (2004) ("As a policy matter, we believe that any service provider that sends traffic to the PSTN should be subject to similar compensation obligations, irrespective of whether the traffic originates on the PSTN, on an IP network, or on a cable network. We maintain that the cost of the PSTN should be borne equitably among those that use it in similar ways.").

[32] Comments of SBC Communications Inc., *IP-Enabled Services*, filed in WC Docket No. 04-36, May 28, 2004, at 77-80 ("*SBC IP-Enabled Services Comments*"); Reply Comments of SBC Communications Inc., *IP-Enabled Services*, filed in WC Docket No. 04-36, July 14, 2004, at 51-55 ("*SBC IP-Enabled Services Reply Comments*").

PSTN traffic,[33] the use of those facilities "by definition constitute[s] a part of the interstate access service" and should be governed by interstate access rules.[34]

The application of interstate access charges for all IP-to-PSTN traffic (pending adoption of comprehensive intercarrier compensation reform) is also the most reasonable approach from an economic perspective. As IP-enabled services become widespread, many subscribers will use them as replacements for ordinary circuit-switched telephony. To ensure industry stability during the transition to a unified intercarrier compensation regime, LECs should not receive substantially less during this process than they currently receive in compensation when they originate or terminate traffic over the PSTN. That compensation traditionally involves the assessment of reciprocal compensation for local calls, interstate access charges for long distance calls that cross state boundaries, and intrastate access charges for toll calls that remain within state boundaries. Of those three types of payment obligations, reciprocal compensation typically is the lowest and intrastate access charges are the highest. Interstate access charges, which fall in between, thus serve as a rough proxy for the compensation that PSTN providers would receive in

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[33] Memorandum Opinion and Order, *Vonage Holdings Corporation*, 19 FCC Rcd 22404, 22411-12 ¶ 14 (2004).

[34] Memorandum Opinion and Order, *Bill Correctors v. Pacific Bell*, 10 FCC Rcd 2305, 2308 ¶ 17 n.41 (1995) (citing *California v. FCC*, 567 F.2d 84 (D.C. Cir. 1977)); *see* 47 C.F.R. § 69.1(a) (establishing "rules for access charges for interstate or foreign access services"); *id.* § 69.2(b) (stating that "[a]ccess [s]ervice includes services and facilities provided for the origination or termination of any interstate or foreign telecommunication"). That rule applies even though such services or facilities may, in limited instances, include an intrastate component. The Commission reached this precise jurisdictional conclusion when it ruled that DSL service is jurisdictionally interstate and is thus properly tariffed at the federal level, even though some of the traffic it carries "may be destined for intrastate or even local Internet websites or databases." Memorandum Opinion and Order, *GTE Telephone Operating Cos.*, 13 FCC Rcd 22466, 22478-79 ¶ 22 (1998) ("*GTE Order*"); Memorandum Opinion and Order, *Telerent Leasing Corp.*, 45 F.C.C.2d 204, 218 ¶ 36 (1974) (asserting federal jurisdiction over the interconnection of customer-provided communications equipment with the PSTN, stating that "this Commission has repeatedly exercised jurisdiction over facilities and instrumentalities used in interstate communication despite the circumstance that such facilities are used also to provide intrastate service").

the absence of widespread conversion to IP-enabled services. Indeed, depending on customer traffic patterns, use of interstate access charges may somewhat *understate* what PSTN providers would otherwise receive because, at least in the near term, flat-rated VoIP services may be attracting heavy users of circuit-switched toll services, for which compensation is recovered *exclusively* through interstate and (higher) intrastate access charges.[35] And there can be no doubting the reasonableness of interstate access charges; the Commission has approved them as consistent with sections 201 and 202 of the Act, and it has removed implicit universal service support from them in connection with the CALLS and MAG plans.[36]

Finally, in the event the Commission does not apply interstate access charges uniformly to IP-PSTN calls, it should promptly clarify that, pending broader reform of intercarrier compensation, local telephone companies should continue to charge "jurisdictionalized" compensation rates for IP-PSTN traffic (notwithstanding its interstate nature) in accordance with their existing tariffs. Those tariffs contain various methods to deal with the lack of geographically accurate endpoint information, such as the use of calling party number information together with other data.[37] Such clarification from the Commission is essential to protecting local telephone companies from unlawful access charge avoidance schemes that could

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[35] *See* VoIP Fact Report, filed in WC Docket No. 04-36, May 28, 2004, at 16, 18; *VoIP fast becoming Mainstream Service yet multiple standards still exist*, M2 Presswire, 2004 WL 74988509 (Apr. 26, 2004).

[36] *See* Sixth Report and Order, *Access Charge Reform*, 15 FCC Rcd 12962, 12975-76 ¶ 32 (2000) ("*CALLS Order*"); Second Report and Order and Further Notice of Proposed Rulemaking, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, 16 FCC Rcd 19613, 19617 ¶ 3 (2001) ("*MAG Order*").

[37] *See, e.g.*, Pacific Bell Telephone Company Schedule Cal. P.U.C. No. 175-T, Section 2.3.14; Pacific Bell Telephone Company Tariff F.C.C. No. 1, Section 2.3.14. Until the Commission addresses the access charge issues raised in this proceeding or otherwise changes its access charge rules, these provisions continue to govern the application of access charges to IP-to-PSTN services.

jeopardize the affordability of local rates during the transition to a unified intercarrier compensation regime.

B. The Commission Should Address Compensation for ISP-Bound Traffic Without Artificially Constraining the Scope of Section 251(b)(5)

In 1999 and again in 2001, the Commission sought to correct a particular intercarrier compensation problem by establishing a glide-path toward bill-and-keep for dial-up Internet traffic bound for ISPs served by CLECs. In its 2002 decision in *WorldCom, Inc. v. FCC*,[38] the D.C. Circuit rejected the precise details of the Commission's legal justification for that policy, but left the policy itself in place. The court recognized that the bill-and-keep savings clause of 252(d)(2), on which the Commission had *not* relied, might well give the Commission independent authority to impose a bill-and-keep regime for this and all other traffic within the scope of section 251(b)(5).[39]

If, in its pending remand proceeding, the Commission addresses the question of ISP-bound traffic before it implements broader reforms, it should take particular care to ensure that it does not foreclose its future jurisdiction to adopt a unified intercarrier compensation regime for *all* telecommunications traffic, including access traffic. In particular, the Commission should avoid any suggestion that, by its own terms, section 251(b)(5) must be construed in a way that permanently excludes ISP-bound traffic—and, by implication, intrastate access traffic—from its scope. The reason is that, although ISP-bound traffic falls within the scope of the Commission's

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[38] 288 F.3d 429 (D.C. Cir. 2002).

[39] *Id.* at 434 (explaining that "there is plainly a non-trivial likelihood that the Commission has authority to elect" a bill-and-keep system for section 251(b)(5) traffic pursuant to section 252(d)(2)(B)(i)); *see* 47 U.S.C. § 252(d)(2)(B)(i) (authorizing "arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements")).

section 201 jurisdiction over interstate traffic, purely intrastate traffic does not. To fold such traffic within its jurisdiction, the Commission will wish to rely on its *Iowa Utilities Board* authority to address such traffic under section 251(b)(5), as the D.C. Circuit suggested it do in *WorldCom*, and as the ICF explains in its October 2004 legal brief.[40] That authority could be unavailable, however, if the Commission were to construe section 251(b)(5) to include only local, non-access traffic, as some have proposed.[41]

In an *ex parte* filed in this docket, SBC has explained how the Commission, if it is not yet prepared to adopt bill-and-keep for *all* traffic under sections 251(b)(5) and 252(d)(2), may nonetheless impose bill-and-keep for ISP-bound traffic—but without adopting an unduly narrow view of the permanent scope of section 251(b)(5).[42] The Commission should follow that approach if it addresses the ISP reciprocal compensation issues before completing its comprehensive reform of intercarrier compensation.

C. The Commission Should Act Expeditiously to Reform the Existing Universal Service Contribution System

For years, SBC and many others have pressed the Commission to reform the existing USF contribution methodology, which bases contribution obligations on revenues for interstate telecommunications services. As discussed below, that methodology is competitively skewed,

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[40] *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 378-380 (1999) (holding that the Commission has plenary jurisdiction to address any issues arising under sections 251 and 252); Ex Parte Brief of the Intercarrier Compensation Forum in Support of the Intercarrier Compensation and Universal Service Reform Plan, filed in CC Docket No. 01-92 (Oct. 5, 2004) at 28-32 ("*ICF Ex Parte Brief*").

[41] *See* Letter from Ann D. Berkowitz, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 99-68 (filed May 17, 2004) (arguing (i) that section 251(b)(5) applies only to "traffic that originates on the network facilities of one local exchange carrier and terminates on the network facilities of an interconnecting local exchange carrier within the same local calling area" and (ii) that ISP-bound traffic does not meet that standard).

[42] *See* Letter from Gary L. Phillips, SBC Communications Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Sept. 13, 2004).

unlawful, and increasingly unsustainable. One reason SBC supports the ICF plan is that the plan would comprehensively reform the contribution methodology and ensure regulatory parity among intermodal competitors.

Under the current system, the contribution obligations of communications providers rest on regulatory distinctions—between, for example, "interstate" and "intrastate" services and between "telecommunications services" and "information services"—that have become increasingly irrational with the emergence of new Internet applications and the proliferation of various service bundles.[43] And the rules allow some providers to make reduced contributions or none at all. More and more providers can thus serve customers without contributing to federal universal service support. This leaves the carriers that do contribute with an escalating share of the burden—a burden that gets passed along to their dwindling customer base in the form of ever-higher rates.

Perhaps the starkest example of this regulatory irrationality—and the one the Commission could immediately rectify as an initial step forward—is the contribution disparity among intermodal broadband competitors. One key service subject to a mandatory contribution is DSL, because the "transmission component" of DSL—which wireline carriers are forced to

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[43] As the Commission has explained:

> [I]nterstate telecommunications revenues are becoming increasingly difficult to identify as customers migrate to bundled packages of interstate and intrastate telecommunications and non-telecommunications products and services. This has increased opportunities to mischaracterize revenues that should be counted for contribution purposes. Such mischaracterization may result in decreases in the assessable revenue base. Increased competition also is placing downward pressure on interstate rates and revenues, which also contributes to the decline in the contribution base. . . . Customers also are migrating to mobile wireless and Internet-based services. As we recently noted, these changes have led to fluctuations in the contribution base and rising contribution obligations.

Report and Order and Second Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, 17 FCC Rcd 24952, 24955 ¶ 3 (2002).

tariff and sell separately from any information service—is an interstate telecommunications service.[44] At the same time, however, the FCC has insulated cable companies from any obligation to contribute a percentage of the revenues *they* earn in the sale of "cable modem service." This regulatory disparity is senseless. As the D.C. Circuit has observed (and as is beyond dispute), cable modem service is a market substitute for DSL, and "[t]he Commission's own findings" confirm "the dominance of cable[] in the broadband market."[45] Moreover, the FCC has undisputed *authority* to require cable modem providers to contribute to the fund because cable modem service involves the provision of "telecommunications," a sufficient condition under the Communications Act for the imposition of a contribution obligation.[46] But the Commission has persistently failed to act on that authority. DSL providers must therefore pay what amounts—today—to an 11 percent tax on the sale of their broadband services as they struggle to compete with the market-share leading cable modem providers, which pay no such tax. And that disparity is certain to grow. The ultimate victims are the consumers who would benefit from fair competition to cable companies in the market for broadband Internet access.

This regulatory anomaly is not just economically perverse, but unlawful. As the Commission itself determined in 1997, its universal service scheme must adhere to a core principle of "competitive neutrality," which "means that universal service support mechanisms

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[44] Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities, Universal Service Obligations of Broadband Providers*, 17 FCC Rcd 3019, 3035-39, 3051 ¶¶ 30-42, 72 (2002) ("*Wireline Broadband NPRM*").

[45] *United States Telecom Ass'n v. FCC*, 290 F.3d 415, 429 (D.C. Cir. 2002) ("*USTA I*").

[46] 47 U.S.C. § 153(43), (46); *see* Declaratory Ruling and Notice of Proposed Rulemaking, *Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, 17 FCC Rcd 4798, 4823 ¶ 39 (2002) ("*Cable Modem Declaratory Ruling*"), *vacated on other grounds by Brand X Internet Services v. FCC*, 345 F.3d 1120 (9th Cir. 2003), *cert. granted*, 125 S. Ct. 654 (2004).

and rules neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another."[47] But the singular burden on DSL providers in the broadband market creates an enormous competitive disparity that arbitrarily favors the market leader, dampens competition, and reduces consumer choice. As FCC Commissioner Kathleen Abernathy has explained, "the fact that [telephone companies] providing DSL service currently contribute to universal service, while cable modem providers do not, creates an obvious competitive distortion."[48]

It has now been more than six years since the FCC concluded, in its 1998 Report to Congress, that this regulatory disparity needed close attention.[49] Then, again in 2002, once more stressing its obligation to ensure "competitive neutrality" in the assessment of contribution obligations,[50] the Commission formally teed the same issue up for resolution in two rulemaking proceedings: the *Wireline Broadband* proceeding (CC Docket No. 02-33) and the *Contribution Methodology* proceeding (CC Docket No. 96-45).[51] Also in 2002, a majority of the FCC

[47] See Report and Order, *Federal-State Joint Board on Universal Service,* 12 FCC Rcd 8776, 8801 ¶ 47 (1997) ("*Universal Service Order*").

[48] Separate Statement of Commissioner Kathleen Abernathy accompanying Report and Order and Second Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, 17 FCC Rcd 24952 (2002) ("*Second Further Notice*") at 25046 ("Abernathy Statement").

[49] *See* Report to Congress, *Federal-State Joint Board on Universal Service*, 13 FCC Rcd 11501, 11508-09, 11534-35 ¶¶ 15, 69 (1998) ("*Report to Congress*").

[50] *See, e.g., Wireline Broadband NPRM* at 3054 ¶ 80.

[51] *See id.* at 3028-29, 3052 ¶¶ 16, 74; Further Notice of Proposed Rulemaking and Report and Order, *Federal-State Joint Board on Universal Service*, 17 FCC Rcd 3752, 3754, 3782-84 ¶¶ 4, 67, 69 (2002) ("*Further Notice*").

acknowledged that "the DSL/cable modem contribution disparity" was an "obvious" problem, with Commissioner Copps expressing "disappoint[ment]" that the FCC had not already fixed it.[52]

But another three years have passed without resolution of this issue, and the clock keeps ticking. In the meantime, this regulatory disparity has subjected DSL providers to an ever-worsening competitive disadvantage as they seek to catch up in the broadband market. In 1998, the first year in which the current contribution requirement took effect, the FCC set the "contribution factor"—the percentage of assessable revenues that telephone companies must contribute to the fund—at under three percent.[53] Since then, the FCC has steadily increased that factor to a new high of *11.1 percent* for the second quarter of 2005—a 24 percent increase over the factor in effect in the fourth quarter of 2004, and *426 percent* over its 1998 level.[54] By

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[52] Separate Statement of Commissioner Michael Copps accompanying *Second Further Notice* at 25047 ("Copps Statement"); Abernathy Statement at 25046; *see also* Separate Statement of Chairman Michael K. Powell accompanying *Second Further Notice* at 25043-44 ("Powell Statement").

[53] *See* "Proposed First Quarter Universal Service Contribution Factors," Public Notice, DA 97-2392 (rel. Nov. 13, 1997). In 1998, the FCC established contribution factors for two separate universal service programs; these were 1.66 percent for the High Cost and Low Income program, and 0.45 for the Schools and Libraries Program. Starting in 2000, the FCC issued one combined contribution factor. *See* "Proposed First Quarter 2000 Universal Service Contribution Factor," Public Notice, DA 99-2780 (rel. Dec. 10, 1999).

[54] *See* "Proposed Second Quarter 2005 Universal Service Contribution Factor," Public Notice, DA 05-648 (rel. Mar. 10, 2005). The contribution factor in effect in the fourth quarter of 2004 was 8.96 percent. *See*, "Proposed Fourth Quarter 2004 Universal Service Contribution Factor," Public Notice, DA 04-2976 (rel. Sept. 16, 2004). These percentages translate into an immense burden for DSL providers. Over the last several years alone, SBC has had to pay many hundreds of millions of dollars in DSL-related universal service contributions to the fund. Given the trend of ever increasing contribution factors, the lopsided burden on DSL providers as compared to cable modem service providers is likely to grow over time if not corrected. Indeed, had Congress not taken extraordinary last-minute action in December 2004 to exempt the universal service fund from the Anti-Deficiency Act, by all accounts the contribution factor for the first quarter of 2005 would have risen to nearly 13 percent. This reprieve, however, is only temporary, because the recently legislated exemption is set to expire at the end of 2005. National Telecommunications and Information Administration Organization Act, Pub. L. No. 108-494, § 302, 118 Stat. 3986, 3998 (2004). After that time, absent further congressional action, the FCC can be expected to raise any shortfalls that remain unrecovered by the fund—which today amount to $550

contrast, SBC's major broadband competitors, such as Time-Warner and Comcast, pay nothing at all on their revenues for cable modem service. And the existing scheme exacerbates this artificial disparity by permitting VoIP providers (including these vertically integrated cable companies themselves) to provide, over the cable modem platform, voice services that do not contribute to universal service. Because cable modem service is the platform on which VoIP is most commonly run, exempting both (or either) from any USF contribution obligation necessarily pulls minutes and thus revenues away from the circuit-switched PSTN, thereby progressively shrinking the assessment base for USF contributions.

This asymmetry is a problem not just for traditional wireline carriers, but for rural consumers, in that it risks further financial destabilization of the universal service funding mechanisms themselves. Since 2000, revenues from traditional interstate "switched access" phone service—one of the major components of the fund's contribution base—have declined precipitously, leading to the sharp increases in the contribution factor for carriers subject to assessments.[55] The Commission's current contribution rules, by providing an incentive to customers to choose non-contributing cable modem service, will only exacerbate this trend.[56] The result is a classic regulatory death spiral. Services that continue to trigger contribution

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million—through further increases to the contribution factor. *See* "Proposed First Quarter 2005 Universal Service Contribution Factor," Public Notice, DA 04-3902 (rel. Dec. 13, 2004).

[55] *See Further Notice* at 3759 ¶ 14; *id.* at 3756 ¶ 8 ("The Common Carrier Bureau recently reported that annual end-user switched interstate telecommunications revenues declined in 2000, the first time since such data has been compiled."); Notice of Proposed Rulemaking, *IP-Enabled Services*, 19 FCC Rcd 4863, 4865-66 ¶ 3 & n.11 (2004) (citing FCC reports indicating that "interstate switched access minutes declined to 486.0 billion minutes in 2002 from 538.3 billion interstate minutes in 2001, and interstate switched minutes declined to 113.8 billion in the first quarter 2003 from 124.8 billion in the first quarter of 2002").

[56] *See Report to Congress* at 11548-49 ¶ 98 (warning against incentives to shift traffic to providers exempt from contribution requirements).

obligations will be priced higher than they otherwise would be and in most cases higher than comparable competing services that do not trigger such obligations. Customers will thus artificially prefer the latter services to the former. The services burdened with contribution obligations will thus provide fewer revenues to support the fund. Regulators will in turn have to increase the contribution factor still further to make up for the difference, leading to yet higher prices for the burdened services. That will drive still more customers to migrate away from those services, which will in turn lead to another required hike in the contribution factor—and so forth, until the system breaks down altogether. This dynamic is plainly unsustainable and inimical to consumer interests, particularly in the rural areas that rely most on a healthy universal service fund.

The Commission should thus immediately rectify this disparity, and the USF contribution component of the ICF plan marks the path forward by proposing to broaden and stabilize the funding source for universal service by creating a new, unified contribution methodology. Specifically, the plan will rely on a numbers/connection-based assessment methodology under which every provider is assessed one "unit" of contribution for each unique working telephone number it provides, and for each residential DSL, cable modem, and other high-speed, non-circuit-switched connection. Other connections, such as non-switched, dedicated business connections, are assessed different units on the basis of their capacity. This approach will eliminate arbitrary regulatory exemptions from contribution obligations, protect the fiscal stability of the universal service fund over the long term, and ensure, for the first time, fully equitable and competitively neutral contribution obligations for all intermodal rivals in the same markets.

Finally, for the reasons explained in the ICF's October 2004 legal brief, the Commission has full authority to implement this new contribution regime.[57] For the good of the industry and American consumers, it should do so promptly. The longer the Commission waits, the more harm it will do to universal service and the competitive marketplace.

CONCLUSION

Of the several "reform" proposals advanced in this proceeding, the ICF plan offers the only route to a stable, market-oriented intercarrier compensation regime that promotes the interests of all consumers, including those in rural and other high-cost areas. The Commission should adopt the plan, in its entirety, without delay.

Respectfully submitted,

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[57] *ICF Ex Parte Brief* at 46-50; *see also SBC IP-Enabled Services Comments* at 118-19; *SBC IP-Enabled Services Reply Comments* at 85-86.